

Office of Chief Counsel
Internal Revenue Service
memorandum

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date: February 9, 2001

to: Brent Norton, Team Coordinator M/S W133
Internal Revenue Service, LMSB

from: Associate Area Counsel (Large and Mid-Size Business)
Seattle

subject: [REDACTED] / [REDACTED]
Mitigation Issue

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This responds to your request for advice regarding whether [REDACTED], formerly known as [REDACTED] ("the taxpayer") is entitled to refund of an \$ [REDACTED] overpayment for [REDACTED] under the mitigation provisions (sections¹ 1311-1314). The short answer is "yes." Following is our understanding of the facts and our explanation regarding why the taxpayer is so entitled.

FACTS

¹ Unless otherwise stated, all "section" references are to the Internal Revenue Code.

The taxpayer claimed tentative refunds for [REDACTED] and [REDACTED] amounting to \$[REDACTED] and \$[REDACTED], respectively. Because these refunds exceeded one million dollars, the Joint Committee on Taxation must review the Commissioner's decision to refund the overpayments. I.R.C. § 6405(a). You are in the process of preparing the case for the Joint Committee. Given the waterfall effect of net operating losses (NOLs) and NOLs for alternative minimum tax purposes (AMT NOLs), your preparations include reviewing the taxpayer's tax calculations for [REDACTED] through [REDACTED].

In [REDACTED] (as well as in other years), the taxpayer was one of two partners in the [REDACTED] TEFRA partnership. The other partner was [REDACTED]. Pursuant to a consent (Form 872-P), the [REDACTED] statute of limitations with respect to the partnership items was scheduled to expire on [REDACTED].

During an audit of the partnership's [REDACTED] return, the Commissioner asserted that the partnership should have allocated additional depreciation to the taxpayer and less to the taxpayer's partner. By signing a Form 870-P,² the partnership eventually agreed.

On Forms 1120X submitted on [REDACTED], the taxpayer applied the settlement to itself by carrying forward \$[REDACTED]³ in AMT NOLs from [REDACTED] to [REDACTED]. The Commissioner processed the Forms 1120X.⁴

This was a mutual mistake by the taxpayer and the Commissioner (the taxpayer by suggesting the manner in which to apply the settlement and the Commissioner for going along with

² The TMP signed the agreement on [REDACTED]. The copy of the agreement in the file is not signed on behalf of the Commissioner. However, the Appeals Transmittal Memorandum and Supporting Statement indicates that the agreement was counter-signed on [REDACTED].

³ The taxpayer originally claimed \$[REDACTED], which was subsequently corrected to \$[REDACTED].

⁴ Under TEFRA, the taxpayer was not required to file a claim for refund to implement the settlement. I.R.C. § 6230(d)(5) (stating that the Commissioner may credit or refund an overpayment attributable to a partnership item "without any requirement that the partner file a claim therefor"); I.R.C. § 6230(c)(1)(B) (providing that a partner may contest the manner in which the Commissioner applies a settlement to a partner by filing a claim for refund after the Commissioner applies the settlement).

the taxpayer's suggestion). Carryforward from [REDACTED] to [REDACTED] was improper; under section 172(b), the [REDACTED] AMT NOLs should have been carried back to [REDACTED] and the taxpayer should have received a refund of an \$[REDACTED] overpayment.⁵

The limitations period for making adjustments to [REDACTED] (disallowing the AMT NOL carryforward from [REDACTED]) remains open pursuant to a consent. For refunding the [REDACTED] overpayment, however, the limitations periods for filing claims for refund under TEFRA have expired.⁶

The taxpayer asserts that mitigation under section 1312(4) applies to [REDACTED] and allows the Service to refund the \$[REDACTED] overpayment. Recently, the taxpayer documented its position by executing Form 2259, Agreement as a Determination Pursuant to Section 1313(a)(4) of the Internal Revenue Code. On the Form 2259, the taxpayer stated that the AMT NOLs should have been carried back to the now-closed [REDACTED] year. You expect the Commissioner's delegate to counter-sign the Form 2259 soon. Thereafter, the taxpayer intends to submit an amended [REDACTED] return claiming it is entitled to a refund of the \$[REDACTED] overpayment.⁷

⁵ By the amended returns, the taxpayer also suggested carrying forward regular NOLs from [REDACTED] and regular and AMT NOLs from [REDACTED]. The Commissioner applied the settlement in this incorrect manner. The taxpayer has not invoked mitigation with respect to these items because correcting the taxpayer's treatment of the regular [REDACTED] NOL does not produce an overpayment, and the [REDACTED] statute has not expired.

⁶ Although we do not know the exact date, the "regular" section 6501 limitations period for [REDACTED] has also expired.

⁷ The taxpayer must file the claim for refund within one year from the date of the determination (e.g., the Form 2259). I.R.C. § 1314(b); Treas. Reg. § 1.1314(b)-1(b).

You asked us whether mitigation applies and whether, consequently, the Commissioner should allow the taxpayer's expected claim.

DISCUSSION

The taxpayer asserts that the mitigation provisions under sections 1311 through 1314 allow the Commissioner to refund an otherwise barred overpayment amounting to \$[REDACTED] for the year [REDACTED]. Mitigation authorizes an adjustment in certain cases where a determination in an open year establishes that an item has been treated erroneously in a closed year, and the statute of limitations would otherwise prevent correction of the error in the closed year I.R.C. § 1311(a).

For mitigation to apply, the taxpayer must meet the following conditions:

1. A "determination" (as defined in section 1313(a)) must establish that the treatment in one year, the "error year," was incorrect;
2. The determination must result in one of the seven circumstances specifically described in section 1312, e.g., the double disallowance of a deduction or credit (section 1312(4));
3. Correction of the error in another year, the "proper year," must be barred by some rule of law, usually the period of limitations on assessment or refund; and
4. In the case of a double disallowance of a deduction (section 1312(4)), the Commissioner may adjust the taxpayer's tax liability in the proper year only if credit or refund of the overpayment in the proper year was not barred at the time the taxpayer first maintained in writing that it was entitled to the deduction or credit in the error year.

I.R.C. § 1311; see also, Michael I. Saltzman, IRS Practice and Procedure ¶ 5.07[5][d], at 5-74.

We will address each of these requirements.

1. "Determination" Establishes That the Treatment In One Year, the "Error Year," Was Incorrect.

Here, we have both a "determination" and the "incorrect treatment in the error year." A "determination" includes an agreement between the taxpayer and the Commissioner evidenced on Form 2259, "Agreement as a Determination Pursuant to Section 1313(a)(4) of the Internal Revenue Code." I.R.C. § 1313(a)(4); Treas. Reg. § 1.1313(a)-4. The taxpayer signed the agreement; you expect the Commissioner's delegate to also sign it soon.

The Form 2259 (the "determination") establishes that the \$ [REDACTED] in AMT NOLs should not have been carried forward and deducted in [REDACTED], the error year. It expressly states that the AMT NOLs should have been carried back to [REDACTED]. I.R.C. § 172(b). Thus, the Form 2259 "determination" establishes that carryforward of the [REDACTED] AMT NOLs to [REDACTED] was incorrect.

2. "Determination" Must Result in One of Seven Circumstances Described in Section 1312.

Mitigation is allowed only if the determination results in one of the seven circumstances specifically described in section 1312. One of the seven circumstances is section 1312(4), which allows for mitigation where "[t]he determination disallows a deduction or credit which should have been allowed to, but was not allowed to, the taxpayer for another taxable year, or to a related taxpayer."

Here, the determination resulted in a double disallowance. The Commissioner has now determined that the \$ [REDACTED] AMT NOLs should not have been carried forward from [REDACTED] to [REDACTED]; under section 172(b), the AMT NOLs should have been carried back to [REDACTED]. The Commissioner disallowed the carryforward of the [REDACTED] AMT NOLs (the [REDACTED] limitations period on assessment remains open pursuant to a consent). Because the limitations period for [REDACTED] (the proper carryback year) has expired, however (see below under section 3), the Commissioner has also disallowed the deduction in [REDACTED]. Therefore, this "double disallowance" provision has been satisfied.

3. Correction of the Error in the Proper Year Must be Barred.

Under this factor, the limitations period for [REDACTED], the proper year, must now be barred. Normally, section 6511(d)(2)(A) would apply; if it did, the limitation period for the carryback year ([REDACTED]) would be determined with respect to the loss year ([REDACTED]). Section 6511(d)(2)(A) does not apply, however. I.R.C. § 6511(g) (stating that "[i]n the case of any tax imposed ... attributable to any partnership item ..., the provisions of section 6227 and subsections (c) and (d) of section 6230 shall apply in lieu of this subchapter").

Before we explain TEFRA's limitations periods with respect to NOLs, we begin with the basics. A partnership is not a taxable entity. A partnership files an information return on which it reports its income and deductions. Because it is a conduit, its income and deductions are attributed to its partners. The partners report these partnership items on their own returns. The Commissioner, however, adjusts partnership items at the partnership level through the unified partnership audit and litigation procedures enacted by TEFRA (sections 6221-6233).

Partnership items include "[i]tems of income, gain, loss, deduction, or credit of the partnership." Treas. Reg. § 301.6231(a)(3)-1(a)(i). Here, the Commissioner re-allocated partnership items when it determined that the partnership should have allocated additional [REDACTED] depreciation deductions to the taxpayer.

Because its share of the partnership's depreciation deductions increased, the taxpayer's AMT NOLs for [REDACTED] also increased. The increased AMT NOLs for [REDACTED] are computational-type affected items. I.R.C. § 6231(a)(5) (stating that an affected item is any item affected by a partnership item); Treas. Reg. § 301.6231(a)(6)-1T(a) (providing that computational-type affected items require only a mathematical computations once the partnership proceeding is concluded).

Additional carrybacks and carryforwards generated by the increased AMT NOLs are also affected items because section 6231(a)(5) provides that any item affected by a partnership item is an affected item. See Maxwell v. Commissioner, 87 T.C. 783, 790-91 (1986) (stating that the partner's carryback of an investment tax credit is "an 'affected item' since its existence or amount is 'affected by' the investment tax credit that is a partnership item. Sec. 6231(a)(5)."). Here, the [REDACTED] AMT NOLs available to be carried back were affected (increased) by the

amount of the partnership item, i.e., the additional [REDACTED] partnership depreciation allocated to the taxpayer. Consequently, credit or refund of the [REDACTED] overpayment based on the additional AMT NOLs (comprised of the taxpayer's share of depreciation deductions) is also an affected item.

We now examine the limitations period for claiming credit or refund of the affected item (the [REDACTED] overpayment created by carrying back the increased [REDACTED] AMT NOLs). At the outset, we note that TEFRA's limitations periods with respect to NOLs operate "in a manner similar to that provided by section 6511(d)(2)." Harris v. Commissioner, 99 T.C. 121, 131 (1992). Specifically, section 6230(d)(1) provides:

[N]o credit or refund of an overpayment attributable to a partnership item (or affected item) for a taxable year shall be allowed or made to any partner after the expiration of the period of limitations prescribed in section 6229 with respect to such partner for assessment of any tax attributable to such item.

Section 6229(b), in turn, provides that the period of limitations for any tax attributable to any partnership item (or affected item) may be extended from the normal three year period (from filing the return or from the return's due date) by agreement.

Here, the limitations period pursuant to the section 6229(b) consent was open through [REDACTED]. Therefore, under section 6230(d)(1), the limitations period for filing a claim for refund or credit attributable to carrying back the [REDACTED] AMT NOL to [REDACTED] was also extended to [REDACTED].

We turn now to how the settlement affected the statute of limitations. Pursuant to section 6224(c), the partnership and the Commissioner agreed to settle the depreciation deductions issue on [REDACTED]. Thereafter, the taxpayer had two years from the settlement date within which to file a claim for refund for [REDACTED] on the ground that the Commissioner failed to allow a credit or failed to make an overpayment in an amount attributable to the application of the settlement. I.R.C. §§ 6230(c)(1)(B), (c)(2)(B); see Harris, 99 T.C. at 130-31 (stating that where "application of the settlement to the partners produces NOL carrybacks which cause an overpayment in years prior to the years to which the settlement relates," the partner may file a claim for refund under section 6230(c)(1)(B)). In other words, the taxpayer had until [REDACTED], within which to file a claim for credit or refund with respect to the [REDACTED] overpayment. It did

not do this.⁸ Therefore, correction of the error is now barred and the taxpayer has satisfied this mitigation requirement.

4. Limitations Period for Barred Year Open When Taxpayer First Claimed Deduction

The limitations period for the barred year must have been open at the time the taxpayer first maintained in writing that it was entitled to the deduction in the open year. I.R.C. § 1311(b)(2)(B). As we explained in section 3, above, the taxpayer had two years after the partnership's settlement within which to file a claim for refund for [REDACTED] on the basis that the Commissioner failed to allow a credit or to make a refund in an amount attributable to the application of the settlement. I.R.C. §§ 6230(c)(1)(B), (c)(2)(B). Based on these provisions, the taxpayer had until [REDACTED], within which to claim credit or refund of the now-barred [REDACTED] overpayment.

The taxpayer first maintained in writing that it was entitled to the [REDACTED] AMT NOLs for the open year when it submitted the Forms 1120X for [REDACTED] (the loss year) and [REDACTED] (the incorrect year). It did this on [REDACTED]. Because the taxpayer maintained in writing that it was entitled to the additional AMT NOLs two years before the [REDACTED], statute expiration date, the this provision has been fulfilled.

⁸ We do not believe the taxpayer's [REDACTED] and [REDACTED] Forms 1120X, submitted on [REDACTED], qualify as claims for refund for the [REDACTED] year. The regulations under section 6230 provide that "[a] claim for refund under section 6230(c) shall state the grounds for the claim" Treas. Reg. § 301.6230(c)-1T. Here, the taxpayer did not request the correct treatment of the AMT NOLs (carry back from [REDACTED] to [REDACTED]); instead, it requested incorrect treatment (carry forward from [REDACTED] to [REDACTED]). The taxpayer did not request a refund in any amount for [REDACTED]. Thus, the Forms 1120X probably do not satisfy the regulation's requirement that the claim for refund "state the grounds for the claim."

Even if the [REDACTED] and [REDACTED] Forms 1120X are considered as a proper section 6230(c) claim for [REDACTED], the limitations period for filing suit has expired. Suit cannot be filed until six months after the filing of the claim for refund (or earlier if a notice of claim for disallowance is issued) and no later than two years after the claim is filed. I.R.C. §§ 6230(c)(3) and 6532. Because the taxpayer filed the Forms 1120X on [REDACTED], the taxpayer had until [REDACTED], within which to file suit for [REDACTED].

In summary, because all of the requirements set forth above have been satisfied, mitigation allows the Commissioner to refund the [REDACTED] overpayment.⁹

If you should have any questions about this memorandum or if you should need any additional assistance, please contact the undersigned at (206) 220-5951.

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⁹ Bolstering our opinion is a regulation example dealing with net operating losses. Treas. Reg. § 1.1314(a)-1(d). The regulation assumes that mitigation allows refund of overpayment in the correct year (here, [REDACTED]). The point of the example, however, is that mitigation applies where net operating loss carryforwards and carrybacks affect years other than just the correct year (here, [REDACTED]) and the incorrect year (here, [REDACTED]).